



intangible benefits from its IBF activities. For example, IBFs may promote a greater awareness of California banks in international markets, promoting California business internationally.

A recent study by the Franchise Tax Board (FTB) found that the revenue loss due to the IBF tax exemption is relatively small, about \$1 million per year. However, the FTB noted that many banks would transfer their IBFs in order to avoid such a tax, since such transfers are easily accomplished. Further, removing the tax exemption would not equally affect all types of banks operating IBFs in California. Only those banks commercially domiciled in California would have to pay any income tax on IBF income if the tax exemption were repealed. This would place these banks at a competitive disadvantage in the IBF market relative to other banks operating IBFs in California.

LAO concluded its study by recommending the enactment of legislation to continue the tax exemption for IBF income on a permanent basis.

## ASSEMBLY OFFICE OF RESEARCH

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Established in 1966, the Assembly Office of Research (AOR) brings together legislators, scholars, research experts and interested parties from within and outside the legislature to conduct extensive studies regarding problems facing the state.

Under the direction of the Assembly's bipartisan Committee on Policy Research, AOR investigates current state issues and publishes reports which include long-term policy recommendations. Such investigative projects often result in legislative action, usually in the form of bills.

AOR also processes research requests from Assemblymembers. Results of these short-term research projects are confidential unless the requesting legislators authorize their release.

### MAJOR PROJECTS:

*California 2000: Exhausting Clean Air (October 1989).* As the fourth installment of the *California 2000* series, this report focuses on major issues presently facing the state of California in managing air quality. The

report chronicles major events of the last four decades which have directly affected (both negatively and positively) California's ability to deal with the problem of air pollution.

For example, during the 1950s, Dr. Arie J. Hagen-Smit, a California scientist, unlocked the secrets of smog formation. He discovered that ozone, a major ingredient in smog, is formed when reactive organic gases (ROG) and nitrogen oxides (NOx) from automobiles and industries react with sunlight. Then, during the 1960s, California was the first state to tackle air pollution problems by establishing automobile exhaust emission standards for smog-producing ROG and poisonous carbon monoxide (CO) gas. In the 1970s, realizing that controlling ROG and CO emissions without concurrent NOx controls increased smog formation, California was first to require NOx control devices on automobiles. In 1975, the catalytic converter, which dramatically reduced ROG and NOx tailpipe emissions, became standard on most American-made cars sold in California. Yet, during the 1980s, despite technical fixes (tailpipe and smokestack pollution control devices), California continued to violate national and state standards for ozone, NOx, CO, and fine particulate matter.

According to the report, preliminary emissions data from the California Air Resources Board (ARB) reveal fossil fuels (oil, coal, and natural gas) to be the major source of air pollution. Fossil fuel burning and fossil fuel-related sources produce most of the ROG, NOx, and CO pollution in the three most heavily-populated of California's air basins: South Coast, San Joaquin Valley, and San Francisco Bay Area. Paved-road dust, construction/demolition, and farming operations produce most of the polluting fine particulate matter. According to the report, two factors guarantee the spread and increased severity of air pollution danger zones in the future: population growth and increased vehicle miles traveled.

The report documents the health and environmental damages caused by air pollution in California. Health costs include increased lung disease, fatalities in heart-diseased patients, skin cancers, and susceptibility to disease. Environmental costs include crop losses, forest damage, material deterioration, acidification of lakes and streams, visibility restrictions, and climate changes. A 1988 University of Southern

California study estimates the annual air pollution bill for the South Coast Air Basin to be over \$7 billion or approximately \$600 per person. According to a recent study for the South Coast Air Quality Management District, however, the cost may be much higher. All parties agree that the costs will continue to rise in the 21st century as population growth and increased automobile and energy use push pollution to destructive limits.

The report concludes with a variety of recommendations aimed at preventing California from exhausting its clean air supply, including the following:

- Create an incentive program for low-polluting vehicles, which could include waiving new car sales tax and five years of registration fees for those who buy new, low-polluting vehicles, and requiring state and local governments to provide parking preference to people who drive low-polluting vehicles.

- Require the state to introduce low-polluting vehicles into private use by selling fleet vehicles sooner than the current practice of seven years.

- Require petroleum refiners to subsidize methanol and other low-polluting fuels through slightly higher gasoline and diesel prices.

- Require the California Energy Commission (CEC) to promulgate regulations that require electric utilities in the state to provide electric vehicle owners with free replacement of standard residential electricity meters with meters that charge different rates based on time-of-day use.

- Require areas violating state air quality standards and suffering from traffic congestion to enhance traffic flow by first improving traffic signal equipment and timing, or similar strategies, rather than building new roads and adding new lanes, which increase traffic and air pollution.

- Limit funding of infrastructure projects to only those local governments with projects that limit regional air quality deterioration.

- Require the CEC to specify strict energy efficiency measures that must be followed in areas that violate state air quality standards. These measures would be required during the initial design or construction of buildings and when buildings are being refurbished or expanded.

- Require that all refrigerators sold in California after 1993 be made with non-chlorofluorocarbon (CFC)-produced



insulating foam and other non-CFC refrigerants.

-Require the CEC to determine the effectiveness, safety, and feasibility of requiring super-insulated windows in automobiles and buildings with air conditioning systems.

*California 2000: Getting Ahead of the Growth Curve (December 1989).* As the fifth release in the *California 2000* series, this report chronicles the steady and significant increase in California's population and the response to this growth by local governments. As many Californians already know, the state's population growth continues to strain existing public facilities, services, and resources in a vast variety of areas, including the following:

-Traffic congestion is estimated to increase by 15% annually over the next ten years. By 2010, the duration of daily trips and work commutes on the Los Angeles region's roads will increase by 42% and average freeway speed will decline from 31 miles per hour (mph) to 11 mph.

-Deteriorating air quality has resulted in the Environmental Protection Agency's (EPA) designation of 15 California counties as nonattainment areas for ozone. Many of these counties have ignored environmental impact warnings about deteriorating air quality in approving numerous massive development projects.

-Insufficient affordable housing is a problem in almost every highly-populated county in the state. The Association of Bay Area Governments (ABAG) projects the creation of 2.6 million new jobs between 1985 and 2005 in its region, but only one million new housing units for these workers. This inadequate supply raises market prices for housing and severely limits the supply of affordable housing.

-Inadequate solid waste disposal capacity is a serious problem in many counties. The California Waste Management Board projects that the state will exhaust all existing and planned future landfill capacity for disposal of solid waste. Los Angeles County faces the most significant problem: it generates almost 40% of the state's solid waste and has sufficient landfill capacity only through 1994.

-Inadequate sewage capacity and worsening water quality are a problem across the nation, and the most serious cases occur in highly populated states such as California. The San Diego

Metropolitan Sewer District has been cited by the EPA and the state for illegal discharges of untreated wastewater on more than 1,800 occasions.

-Overcrowded classrooms have resulted in a need for at least 26,000 new classrooms by the mid-1990s. Options for improving the use of existing school capacity, such as year-round schools, would significantly reduce but not eliminate the need for extensive new construction.

The first type of local response described by the report involves growth control initiatives. Such measures often take the form of limits on the intensity of development allowed; strict design and performance standards for land and buildings; restrictions on the location of development; reductions in the amount of developable land; and limitations on the total amount of growth allowed over time. In 1988 alone, 109 such measures were considered by California voters. However, only 16% of all proposed growth control measures addressed the connection between growth and the need for necessary infrastructure, and of these measures, less than half were successful.

Many critics of growth control initiatives argue that such measures increase housing and land prices and/or shift growth problems in the controlled community to neighboring jurisdictions. Even growth control advocates admit that although growth controls may temporarily relieve some very localized problems, these measures do not contribute to solving the broader problems such as traffic and air pollution.

The second type of local response detailed by the report is the imposition of developer fees. Because of severe constraints on local revenues and limited fiscal assistance from the state and federal governments, local governments often face enormous difficulty supporting the development of adequate public facilities with public revenues. As a result, local governments have turned to developer fees in order to shift infrastructure costs from the public sector to the owner of a development project. Such payments by developers are the largest source of new public capital in California, amounting to approximately \$3 billion per year. In Orange County, the average fee for a single family house is \$4,421; in the Bay Area, the fee may range from \$6,107 to as high as \$14,000.

Critics of developer financing argue

that developer fees tend to treat new development inequitably by making it pay more than its fair share; new development bears the entire cost of solving problems created by previous development. Another disadvantage of developer financing is that it does not solve the timing problem of providing the funding for infrastructure when it is needed at the beginning of a development. Also, developer financing—because it is passed on to consumers in the form of higher housing prices—tends to make housing less affordable for those in low and moderate income groups.

The last type of local response described in the report is the rapid increase in municipal incorporations. One study of fourteen cities incorporated between 1978 and 1982 found that the new cities formed to exert greater control over land use within the community; improve service delivery, notably in the areas of police, fire, and road maintenance; increase revenue for the local community; obtain more responsible political representation; and defend themselves against annexation attempts by a neighboring city.

The report then discussed interjurisdictional responses to the managing growth. When cross-jurisdictional problems are well-defined and technical solutions clearly exist, interjurisdictional cooperation has been readily available. The result has been the extensive and increasing use of joint powers agreements by local governments to resolve technical, interjurisdictional problems. However, joint powers agreements have found limited application and success in managing growth. The problems of growth management do not lend themselves to technical definition and solution. Recent examples of attempts at interjurisdictional cooperation which met considerable opposition relate to air quality regulation, traffic light coordination, transit operations, transportation management, sewer capacity management, and transportation and land use.

The report concludes by making a variety of recommendations for better statewide growth management, including the following:

-The state should form a blue-ribbon commission to set broad goals and policies concerning the direction growth should take in California, including but not limited to areas in which development is desirable, areas in which development should not occur, and minimum standards defining adequate public facil-



ities and levels of service.

-A newly created Regional Development and Infrastructure Agency, located in each of the state's air basins, would eliminate the artificial lines dividing functionally separate single-purpose regional agencies. This entity would not be a new layer of government but a merger of existing efforts that are now ineffective because of a functional bias toward single goals.

-The report recommends elimination of the geographic division of air pollution control efforts within the air basins established by the Air Resources Board. This approach reflects a simple recognition that air flows freely within each of the basins without regard to legal jurisdictional boundaries.

-The report recommends the elimination of fiscal incentives which encourage sprawling land development requiring public investment in inefficient infrastructure and which deny needed services and infrastructure to poorer communities.

## SENATE OFFICE OF RESEARCH

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Established and directed by the Senate Committee on Rules, the Senate Office of Research (SOR) serves as the bipartisan, strategic research and planning unit for the Senate. SOR produces major policy reports, issue briefs, background information on legislation and, occasionally, sponsors symposia and conferences.

Any Senator or Senate committee may request SOR's research, briefing and consulting services. Resulting reports are not always released to the public.

### MAJOR PROJECTS:

A *Summary of California's Alcohol and Drug Abuse Laws (June 1989)* was released to the public by SOR and Senator John Seymour in December 1989. The report was the result of SB 2599 (Seymour) (Chapter 983, Statutes of 1988), which established a Five-Year Master Plan to Reduce Drug and Alcohol Abuse in California. The report sets forth a compilation and consolidated overview of California laws pertaining to drug and alcohol abuse. The report presents brief summaries of applicable statutes in non-technical language,

and is intended to be an only an introduction to these statutes.

As background information, the report noted that a recent finding by the California Department of Alcohol and Drug Programs indicates that approximately 2.2 million Californians have a problem with alcohol abuse and 2.1 million persons in the state use illicit drugs or use drugs inappropriately. During 1987, 2,488 people died in California as a direct result of alcohol abuse and 2,000 died as a result of drug abuse. Problems caused by substance abuse cost the state approximately \$17.7 billion per year in lost worker productivity, health and medical costs, motor vehicle accidents, violent crimes, social responses, and fire losses.

The report discussed the six major statutes that provide the statutory authority governing the regulation and enforcement of alcohol and controlled substances in California, including the Alcoholic Beverage Control Act, the Uniform Controlled Substances Act, the California Control of Profits of Organized Crime Act, the California Major Narcotic Vendors Prosecution Law, the California Imitation Controlled Substance Act, and the Sherman Food, Drug, and Cosmetic Law.

The report then listed various categories of laws relating to alcohol and drug abuse, including laws relating to use, possession, and soliciting; driving under the influence; sale, dispensing, and administering; adulterating/poisoning food, drink, or water; labeling and advertising; professions and employment; education; the administration of justice; treatment and prevention; and alcoholic beverage licensing and taxation.

*Changes in Our Telephone Regulation: Competition at the Crossroads (September 1989).* In response to a request by Senator Herschel Rosenthal, Chair of the Senate Energy and Public Utilities Committee, the SOR released this report, which provides a comprehensive review of the growth of competition in the telecommunications industry and discusses the response of the California Public Utilities Commission (PUC) to the regulatory challenge it faces.

The traditional system of telecommunications regulation, commonly referred to as rate of return regulation, is intended to assure that four important goals are met: assuring just and reasonable rates; preserving the ability of the utility

enterprise to attract capital on reasonable terms; assuring high quality service and adequate facilities; and preventing abuse of monopoly power and undue discrimination among customers. Rate of return regulation consists of four basic steps: determining the rate base (the stock of capital facilities that the company uses to provide services); determining the firm's cost of capital; adding the operating expenses and depreciation to the rate base; and determining customer rates so as to provide utility stockholders with a fair rate of return on their investment. According to the report, the benefits of this type of regulation include the provision of below-cost basic telephone service while allowing the development of an extremely high quality telecommunications system. Also, the traditional regulatory scheme has allowed for vigorous oversight of the local exchange carriers (LECs) and provided opportunities for customer protection. However, because of ongoing changes in both technology and government policies, both of which have fostered competition in a variety of services, the PUC is examining the desirability and feasibility of establishing an alternative regulatory framework for regulating LECs.

In the past several years, three major proposals for dramatic regulatory change have been submitted for the PUC's consideration by Pacific Bell, GTE California, and the PUC's Division of Ratepayer Advocates (DRA). Although each proposal is different, each entails a significant change in regulation, and each offers increased freedom and flexibility to LECs to enter competitive business. Under each plan, traditional rate of return regulation would be abandoned for incentive regulation, which encourages the utility to act more like an unregulated business and vigorously seek methods to improve productivity and also allows the utility the freedom to enter new markets. The danger of such a system, according to the report, is that the utility still maintains monopoly power in some areas, which could result in anticompetitive behavior. Competitors and consumer groups have opposed the plans offered by Pacific Bell and GTE California, citing the lack of safeguards and the unprecedented flexibility that has increasingly been given the two telephone companies.

In late 1987, the PUC commenced what Senator Rosenthal characterized as